SEP 29 1956
JOHN T. FEY, Clerk

IN THE

Supreme Court of the United States

October Term, 1956

No. 468

GEORGE R. CARR,

Petitioner,

vs.

BEVERLY HILLS CORPORATION, a corporation; JOHN P. LORDAN, MAYNARD BRANDSMA, FRANCIS E. BROWNE, ROBERT W. LANGLEY, HARRY F. DIETRICH, and ROSS J. FERRAR,

Respondents.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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Respondents.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Your petitioner, George R. Carr, plaintiff below, prays that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the Ninth Circuit, entered in the above entitled case on May 23, 1956; rehearing denied July 30, 1956. The opinion of the Court of Appeals (No. 14349) is not yet reported, it is printed in Appendix B hereto. The opinion is consistent in error in following similar decisions in *Smith v. Sperling* (D. C. Cal. 1953), 117 Fed. Supp. 781, and the opinion of the United States Court of Appeals for the Ninth Circuit, affirming that decision (No. 14,334, not yet reported) which is presently pending before this Court on Petition for Certiorari, October term, 1956.

Jurisdiction.

The judgment of the United States Court of Appeals for the Ninth Circuit was dated and was entered on May 23, 1956 [R. 283, 289], affirming the judgment of the United States District Court for the Southern District of California. A Petition for Rehearing was filed by petitioner within the time allowed therefor and was denied by Order dated July 30, 1956 [R. 290].

The jurisdiction of this court is invoked under the provisions of Title 28, United States Code, Section 1254(1), 62 Stat. 928.

Questions Presented.

Whether or not the jurisdiction of the United States District Court properly invoked in a stockholders suit between parties who are citizens of different states, may be destroyed by the court in realigning the corporate defendant as a plaintiff even though the complaint complied with the allegations required of rule, where it clearly appears that such defendant corporation unites with other defendants in resisting plaintiff's claim of illegality and fraud, after a demand had been made to bring suit, and the District Court found that such demand would have been futile, if made.

Statutes Involved

The statutory provisions involved are Title 28, United States Code, Section 1332(a)(1), and Rule 23(b), Federal Rules of Criminal Procedure. They are printed in the Appendix A, *infra*.

Statement of the Case.

George R. Carr, an Illinois citizen and stockholder of Beverly Hills Corporation, a California corporation, sued in the United States District Court for the Southern District of California in a stockholders derivative action. Named as defendants in the suit were the California corporation, and various California citizens, who, as officers directors, dominated and controlled the corporation at the time of the happening of the matters complained of, and at the time the instant complaint was prepared for filing. No personal liability was asserted against any individuals, other than the individual defendants who as alleged wrongdoers were officers and directors of the respondent corporation, and as such not only prevented said corporation from seeking relief in its own behalf, but united with the individual defendants in opposing this suit.

The basis for federal jurisdiction in the court of first instance was diversity of citizenship and the amount in controversy [R. 2-3].

Respondent Beverly Hills Corporation was organized in early 1949 for the purpose of acquiring various valuable parcels of real estate in Beverly Hills, California, and constructing on a part of that real estate a modern, fully equipped building of great value designed to house an integrated medical clinic, and of leasing a portion of that building to a partnership of doctors for use as a medical clinic [R. 5-6, 223]; the corporation also planned to construct, equip and operate for profit, within said building other facilities, *i. e.*, an X-ray laboratory, a clinical laboratory, and a pharmacy and soda fountain; to construct a paved parking lot on the unoccupied portion of its real estate, adjoining the building, and to operate that parking lot for profit [R. 6-7, 33, 145, 148, 173-174,

179-181, 203, 223-224, 228, 230]. The income of the corporation would thus be made up of the rent to be received from the lease of the clinic portion of the building and the profits to be realized from the operation of the other named facilities [R. 148-150, 155, 173, 180-181, 223-224]. All of the aforesaid was represented to the stockholder in a *pro forma* balance sheet [R. 179-181] and also was speedily abandoned.

Pursuant to said plan, the corporation was organized, and, on February 28, 1949, respondents Lordan, Brandsma, Browne, Langley and Dietrich were elected directors of the corporation; they also constituted the entire board of directors [R. 4, 90, 94, 101, 110, 114]; respondent Lordan was elected president of the corporation on the same date, and still holds that office [R. 114] respondent Brandsma was elected secretary-treasurer of the corporation on the same date, and held that office until November 17, 1950, when he was elected vice-president [R. 4, 90]. Respondent Ferrar became general business manager of the corporation on September 15, 1950, and still holds that office [R. 4, 105]; he became treasurer of the corporation on November 17, 1950, and became secretary of the corporation on or about November 12, 1952, and still holds those offices [R. 4-5, 105]. At all times since October 10, 1950, all of the individual respondents have been and they now are, members of the executive committee of the corporation; they comprise the entire executive committee [R. 5], in actual control. During the holiday season of 1949-1950, and in April, 1950 [R. 145, 203, 225-226], petitioner learned of the proposed corporation and its plans and purposes from respondents Lordan and Brandsma and from his son-in-law, a doctor [R. 145, 203-204, 225-226, 260-261] and, wishing to help provide for the Los Angeles area an outstanding medical

clinic in which his son-in-law could participate [R. 260-261] he, in about April, 1950, purchased 400 shares of the common stock of the corporation and loaned $20,000 in cash to the corporation [R. 3, 146, 204, 261]. This was the first cash the corporation had received and it gave the corporation some credit standing with the bank [R. 261].

Thereafter, during 1950 and 1951, the corporation acquired by purchase ten (10) lots, constituting a single parcel of ground in Beverly Hills, California, for a consideration of about $300,000 and constructed thereon a medical clinic building which occupied about three (3) lots [R. 6]; in 1951 it acquired by lease from Martha Lordan, wife of the respondent Lordan, an additional adjoining lot, hereinafter referred to as lot 761 [R. 6, 27], and in 1952 purchased said lot 761 for $35,000 [R. 6]. At considerable expense the corporation also graded, paved and equipped as a parking lot the unoccupied portion of its real estate, consisting of about eight (8) lots and including lot 761 [R. 6].

During 1951 the corporation completed the construction and equipping of its building, including a clinical laboratory, an X-ray laboratory, and a pharmacy and soda fountain, and leased the greater portion of the building, other than the above facilities, for use as a medical clinic, to a partnership of doctors under the control of the individual respondents doing business under the style "The Beverly Hills Clinic" [R. 6-7, 155].* The building was completed and The Beverly Hills Clinic commenced its operations on or about September 1, 1951

*The same executive committee dominated the corporation and the "partnership."

[R. 155, 177-178, 199, 200, 227]. The Beverly Hills Clinic (hereinafter for brevity sometimes called "The Clinic"), lessee of most of the corporation's building, was a co-partnership of doctors *and of one registered pharmacist,* respondent Ferrar [R. 5, 105, 224]; all of the individual respondents were members and general partners of, and financially interested in, The Clinic [R. 5, 90, 94, 101, 105, 110, 114]; neither petitioner nor the respondent corporation were members of or financially interested in, The Clinic [R. 5].

The partners in The Beverly Hills Clinic, including respondent Ferrar, own and hold 91% of the outstanding stock of the corporation; the six individual respondents, alone, own and hold 42.1% of said stock [R. 60-61]. Their dominant and complete control is obvious.

During 1951 and 1952 the individual respondents, as officers and directors of the corporation, caused the parking lot, the X-ray laboratory, and the clinical laboratory to be fraudulently diverted, as profit-making facilities, from the corporation to The Clinic, and thereby to themselves as members and general partners of The Clinic [R. 9-10, 16-17, 19, 20, 148-150, 173-174]. Such transactions were clearly fraudulent as to Petitioner and the corporation.

In May, 1952, while the corporation, under the terms of its lease from respondent Lordan, held a first right of refusal to purchase lot 761 [R. 28], the individual respondents fraudulently failed and refused to assert said right and permitted respondent John P. Lordan and his wife to sell said lot for $18,500 [R. 10, 17-18, 164, 167] and paid $500 of the corporation's funds to the new owners of lot 761 for an option to purchase said lot for $35,000 [R. 30-31], and several days later did in fact purchase

said lot 761 for the corporation for $35,000 on or about May 27, 1952, from the vendees of John and Martha Lordan [R. 10, 17-18, 66-67, 117-118].

In 1951 the individual respondents fraudulently and wrongfully caused and permitted the pharmacy operated within its building to be diverted, as a profit-making facility, from the corporation and to be placed under a so-called lease to respondent Ferrar with a remainder to respondent Lordan [R. 39-41]. Ferrar had agreed to operate it as an accommodation to, and for the use and benefit of, the corporation [R. 21-24, 149, 169-172]. Since about September 1, 1951, respondent Ferrar has been in possession of said pharmacy and has denied his trust and asserts that the profits from said pharmacy are his own [R. 24, 107-108]. After the corporation had been stripped of all of its profit-making facilities, as described above, the end result was that not only had it lost its expected profits but all of its income was derived from rent [R. 10-11, 148-150]; it became a personal holding company within the meaning of the Internal Revenue Code and subject to taxation as such [R. 11, 148, 150]; the corporate purposes were destroyed; and the majority stockholders voted to wind up and dissolve the corporation [R. 11, 128]. A minority, including petitioner, vigorously opposed this obvious corporate plunder.

In November, 1952, petitioner in Chicago, Illinois, received a telephone call from respondent Lordan in Los Angeles, California, telling petitioner of the appalling state of the corporation's affairs [R. 145, 236, 261]. Respondent Lordan then sent petitioner a letter dated November 13, 1952, confirming said telephone conversation [R. 146, 148-153, 236-237]. These transactions were the first information petitioner had received of the shocking manner

in which the corporation had been stripped of its income-producing facilities [R. 146, 261] and he immediately instituted an investigation into so much of the affairs of the corporation as was permitted by respondents [R. 147].

In early December, 1952, petitioner's attorneys commenced this investigation of the foregoing transactions [R. 9, 12, 125]. At about that time, petitioner's attorneys were informed by respondent Lordan that the Los Angeles law firm of Gibson, Dunn & Crutcher had been retained as legal counsel for the corporation [R. 12, 125, 135]. Thereafter, during December, 1952, and January, February and March, 1953, petitioner's attorneys made many demands and repeated efforts to inspect the books and records of respondents' corporation [R. 154] and to investigate the above transactions, but they were permitted to make only a limited inspection [R. 9, 11-16]. In mid-March, 1953, the attorneys for respondent corporation learned that petitioner had prepared and was about to file the instant suit against the respondents [R. 15, 133]; thereafter, on or about March 24, 1953, the attorneys for respondent corporation instigated and contrived a course of conduct [R. 134] to have respondents Brandsma, Browne, Langley and Dietrich resign as directors of the corporation and to choose and elect their own successors. This was done [R. 15-16, 134, 136]. Respondent Lordan remained a director and president of the corporation [R. 114], respondent Ferrar remained as secretary-treasurer and general business manager of the corporation [R. 105]. All of the individual respondents continued as members of the executive committee of the corporation and partnership [R. 5] and thus in complete control of both.

Having been unsuccessful in his efforts to obtain relief through the corporation [R. 9, 11-16] petitioner, on April 30, 1953, filed this action in the District Court [R. 2-45]. The law firm of Gibson, Dunn and Crutcher, from which petitioner's attorneys had been trying to secure vital information of the corporation's affairs for nearly four months. continued to represent defendant corporation until on or about May 4, 1953 [R. 142] opposing said suit; at all times herein mentioned they have represented, and do now represent, the individual respondents fraud feasors. On or about May 4, 1953, respondent corporation retained its present counsel, the law firm of Latham & Watkins [R. 142], apparently to show its "independence" of other respondents.

Respondent corporation and the individual respondents, on July 22, 1953, filed their separate but identical dilatory motions (1) to dismiss for failure to state a claim upon which relief can be granted [R. 46, 88] or (2) in the alternative, for a security bond pursuant to Section 834(b) of the California Corporations Code [R. 46, 88]. The individual respondents also moved to strike the complaint as sham, false, vexatious and frivolous [R. 88]. The question of jurisdiction over the subject matter based upon non diversity of citizenship *was never originally raised by the parties.* Said motions having been argued and submitted for decision the District Court, on December 10, 1953, made its order dismissing the case on the ground that it *probably* (*sic*) lacked jurisdiction over the subject matter of the action and hence lacked jurisdiction to entertain the motions [R. 253].

Thereafter, on December 23, 1953, respondent corporation and the individual respondents filed their separate motions (1) to dismiss the complaint for lack of jurisdiction over the subject matter of the action (2) and in

the alternative, renewing their previous motions [R. 254, 257]. Said motions were argued and submitted to the court on January 11, 1954, and the court then announced its decision that the motions to dismiss for lack of jurisdiction over the subject matter were granted, and on January 27, 1954, made and filed its Finding of Fact and Conclusions of Law [R. 264] and Judgment [R. 271].

The Court of Appeals affirmed the Order of Dismissal for lack of jurisdiction (App. B). The decision of the Court of Appeals is not yet reported.

Reasons for Granting the Writ.

(1) In holding that the respondent corporation should be realigned as a petitioner and thus destroy the jurisdiction of the United States District Court where proper *diversity* had been alleged, both the Court of Appeals and the District Judge below departed from established legal precedent and decided an important question of law in a manner directly in conflict with the established decisions of this Court in *New Jersey v. Mills,* 113 U. S. 249; *Railroad v. Grayson,* 119 U. S. 240; *Doctor v. Harrington,* 196 U. S. 579; *Venner v. Great Northern,* 209 U. S. 24, 31, 32; *Delaware & Hudson v. Albany & Susquehanna,* 213 U. S. 435, 451; *Indianapolis v. Chase Bank,* 314 U. S. 63; *Koster v. Lumbermen's Mutual,* 330 U. S. 518.

(2) The Court of Appeals decision is in conflict with established decisions of other Courts of Appeals, in the cases of: *Groel v. United Electric Co.* (C. C. N. J.), 132 Fed. 252; *Lavin v. Lavin* (2 Cir. 1950), 182 F. 2d 870; *Schmidt v. Esquire* (7 Cir. 1954), 210 F. 2d 908, leading Courts of Appeals throughout the United States.

Other decisions of this court which should control in the instant case, but which were ignored by both courts

below are: *Meyer v. Fleming*, 327 U. S. 161; *Greenwood v. Freight*, 105 U. S. 13; *East Tennessee R. Co. v. Grayson*, 119 U. S. 240. The Court of Appeals not only disregarded but actually flouted its own decision in *Cutting v. Woodward* (C. A. 9), 255 Fed. 633, 635. The case is so closely in point as to shock one's sense of Justice.

This is also the rule of decision of the California Supreme Court in *Wickersham v. Crittenden*, 106 Cal. 329, 331.

(3) The question presented by this petition for review on writ of certiorari is of tremendous social and legal importance. The decisions of the United States District Court for the Southern District of California in this case, and in the case of *Smith v. Sperling* (S. D. Cal. 1953), 117 Fed. Supp. 781, which were affirmed by the United States Court of Appeals for the Ninth Circuit, in this case on May 23, 1956 (No. 14,349, not yet reported), and in *Smith v. Sperling* (No. 14,334, not yet reported), on May 21, 1956, not only depart from the applicable decisions of this court, and conflict with the decisions of the various other courts of appeals, but they tend to establish a rule in the Ninth Circuit which will effectively close the doors of the federal courts to shareholders who are compelled to bring secondary or derivative actions in order to protect themselves from their own corporations, and who seek federal jurisdiction based upon diversity of citizenship. Unless these unfortunate decisions are reviewed and corrected the tens of thousands of persons who have invested in corporate shares will have lost one of the most effective of their few methods for compelling corporate management to respect its obligations of trust. With the filing of this petition both of said decisions are now pending before this court on Petition for Certiorari.

The Court of Appeals Opinion.

In affirming the District Court Order of Dismissal for lack of Jurisdiction of the Subject Matter, apparently for non-compliance with Rule 23(b) of the Rules of Civil Procedure, the Court of Appeals engaged in six page rationalization of its position which bears careful study by this court, particularly in light of its departure from established precedent. There is no room for dispute but that the Court of Appeals relied in chief upon the trial court's rulings of law and findings of fact and, insofar as legal precedent was concerned, upon its own and the District Court's erroneous ruling in the case of *Smith v. Sperling* (C. A. 9), No. 14334, ... F. 2d ..... (not yet reported), and *Smith v. Sperling,* 117 Fed. Supp. 781. No other legal precedent was cited.

Both the Court of Appeals and the District Court based its ruling on its *finding of fact* that the Beverly Hills Corporation was at the time of the Commencement of the Action possessed of an "independent volition" to prosecute its own suit, even though it had not done so; and had, in fact, actively opposed such action. All this in the face of a finding by the District Court, as alleged by Petitioner's Complaint that a demand had been made on the Corporation to join in the suit. Both the courts below based their ruling on the so-called "lawyer made" independent board of directors, who in fact were not independent, but upon whom no demands were made. Both the courts below found that such demand "would have been futile" [R. 266, 287].

Apart from the realities of the situation, the lower courts are reduced to the absurd position that petitioner's suit, although it is in classical compliance with Rule 23(b), is defeated for lack of jurisdiction because a "futile de-

mand" was not made on an "independent directorate," who in fact, in this case have actively and vigorously opposed the instant suit to recover for the fraudulent losses inflicted by the individual defendants-respondents, who selected their "independent successor directors" to carry on the fight to defeat the suit for the Corporation's benefit, and so far have done an excellent job of defeating "independent" corporation rights against the individual respondents.

If there is anything left of "fireside justice," it should be applied to these respondents with a strait jacket. By way of repetition, it should be pointed out that the rulings below were in no way based upon an alleged failure of petitioner to comply with the requirements of Rule 23(b). The verified complaint alleged, and the District Court found that the petitioner was a shareholder at the time of the transactions complained of [R. 3, 265, 286], that the action was not a collusive one to confer on the District Court jurisdiction of any action of which it would not otherwise have jurisdiction [R. 3, 267, 287], and that it would have been futile for petitioner to make further demands upon the Corporation for relief [R. 11-16, 266, 287], in view of his previous efforts as alleged with particularity in the Complaint [R. 11-16], the ruling of the courts below seem absurd.

Absent collusion, the instant complaint was one which clearly conferred jurisdiction in the District Court; and it was only by the subterfuge of "trial by affidavit"—which at most contradicted the sworn complaint that the courts below were able to "manufacture" the argument that the Respondent Corporation could be re-aligned as a plaintiff in a suit for its benefit, but which it was nonetheless opposing in union with the alleged fraudulent in-

dividual defendant-respondents. It is fundamental that a corporation can act only through its directors and officers; but when the directors and officers fail or refuse to act, or as here oppose such action, then the corporation as a practical matter is incapacitated from acting. (*Groel v. United Electric* (C. C. N. J.), 132 Fed. 252, 262.)

The courts findings below, that the Respondent Corporation could act independently to protect its rights against the individual respondents, and at the same time it would be futile to make a demand on it and protect its rights by suit, are two wholly inconsistent findings. The Respondent Corporation's opposition to the suit for its own benefit most cogently reveals its true position as a defendant, and not a plaintiff.

Conclusions.

For the foregoing reasons, this petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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Attorneys for Petitioner.

APPENDIX A.

Title 28, United States Code, Section 1332(a)(1)

"§1332. Diversity of citizenship; amount in controversy (a) The District courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of $3,000 exclusive of interest and costs, and is between: (1) Citizens of different States; . . ."

Rule, 23, Federal Rules of Civil Procedure

". . . (b) Secondary Action by Shareholders. In an action brought to enforce a secondary right on the part of one or more shareholders in an association, incorporated or unincorporated, because the association refuses to enforce rights which may properly be asserted by it, the complaint shall be verified by oath and shall aver (1) that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law and (2) that the action is not a collusive one to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction. The complaint shall also set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees and, if necessary, from the shareholders such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort."

APPENDIX B.

Opinion of the District Court of Appeal.

United States Court of Appeals for the Ninth Circuit.

George R. Carr, Appellant, vs. Beverly Hills Corporation, a corporation, John P. Lordan, Maynard Brandsma, Francis E. Brown, Robert W. Langley, Harry F. Dietrich, and Ross J. Ferrar, Appellees. No. 14,349.

May 23, 1956.

Upon Appeal from the United States District Court for the Southern District of California Central Division.

Before: Stephens, Fee and Chambers, Circuit Judges

James Alger Fee, Circuit Judge:

Appellant Carr, who was plaintiff in the District Court, owned 400, or 1.6% of the 24,521 outstanding shares of stock of Beverly Hills Corporation. This is a stockholders derivative action in which the corporation, four former members of its Board of Directors and two present officers thereof, one of whom is presently, and at the time complained of was, a member of the Board thereof, were joined as defendants. The complaint alleged that the individual defendants negligently and fraudulently managed the affairs of Beverly Hills during the period 1951-1952. Judgment is prayed against the individuals in favor of Beverly Hills for damages, accounting and attorney fees for plaintiff.

Defendants moved to dismiss the complaint on the ground of lack of jurisdiction and for failure to state a claim upon which relief can be granted. The facts relative to these issues were presented by affidavits and counter-affidavits by the consent of the parties. Defendants sought to have the case determined in the manner of

summary judgment, on the ground that there were no genuine issues of fact, but the court refused.

Here the trial court, upon a hearing in which all parties joined and upon presentation of proof by affidavits, found that there was no jurisdiction because there was no diversity of citizenship if Beverly Hills and Carr were aligned together as plaintiffs, inasmuch as the corporation and the individual defendants, all citizens of California, would be on both sides of the controversy.[1]

The sole issue before this Court then is whether or not the District Court determined correctly that it did not have jurisdiction over the subject matter of the action.

But the solution of this problem involves two other questions. First: Was the trial court bound to try the whole case upon the merits before determining the question of jurisdiction? Or, on the other hand, could a determination of the essential facts regarding the domination of Beverly Hills by certain of its Directors be made before trial of the other issues in order correctly to align the parties? Second: Were the findings of the court to the effect that there was, at the time of the commencement of action, no domination of Beverly Hills resulting in the destruction of its independent volition, clearly erroneous?

The question of jurisdiction can be raised either by motion to dismiss or by answer. It cannot be waived. Formerly, when bound by formalities, it might have been thought that a motion to dismiss went only to matters on the face of the complaint. But procedure is set up

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[1]See Smith vs. Sperling, 9 Cir., No. 14,334, filed May 21, 1956, and Smith vs. Sperling, 117 F. Supp. 781.

whereby it can be discovered whether there is a true issue of fact raised by a pleading. If there is no genuine issue of material fact, the court may grant judgment. If there is one fact or set of facts, which is established, the court may accept it as uncontroverted and try the remaining issues. All this may now be done where the complaint is the only pleading before the court.

By another rule, the court is empowered to isolate and try any issue in the case. Rule 42(b), Federal Rules of Civil Procedure. Since jurisdiction depends upon the facts and not, in the final analysis, upon the pleading, we hold it was proper for the court to try the facts at the basis of this question before going further. This is especially to be commended because, as noted above, the question must be tried, is decisive and cannot be waived. There is nothing inconsistent in this determination with the cases tried or disposed of before the Federal Rules of Civil Procedure were adopted. All these are to be distinguished.[2]

In this case, the question of fact was tried on affidavits. Although the trial of an issue of fact upon affidavits has been much criticized by textwriters and others as much more liable to error than one where the witnesses are available for cross-examination, and although such a trial is contrary to the almost universal practice of the federal courts, the point need not be considered by us in this case. Plaintiff and defendant could consent expressly to

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[2]Doctor vs. Harrington, 196 U. S. 579; Venner vs. Great Northern Railway Company, 209 U. S. 24; Central Railroad Company of New Jersey vs. Mills, 113 U. S. 249; Cutting vs. Woodward, 9 Cir., 255 Fed. 633. Koster vs. (American) Lumbermens Mutual Casualty Co., 330 U. S. 518, is a forum non conveniens case, and whatever is said about the question herein involved is dictum. See Swanson vs. Traer, 7 Cir., 230 F. 2d 228.

a determination without oral testimony. We hold they did acquiesce in a trial in camera upon affidavits. It was their case and they could try it any way they chose. No one has raised any objection on this score.

This Court has reviewed carefully the record. The findings of the trial court are approved as follows:

"(1) The plaintiff, George R. Carr, was at the time of the commencement of the within action and now is a citizen and resident of the State of Illinois.

"(2) The defendant, Beverly Hills Corporation (hereinafter for brevity sometimes referred to as the defendant Corporation or the Corporation) was at the time of the commencement of the within action and now is a corporation duly organized and existing under the laws of the State of California and is a citizen of said state.

"(3) The defendants, John P. Lordan, Maynard Brandsma, Francis E. Browne, Robert W. Langley, Harry F. Dietrich and Ross J. Ferrar, each was at the time of the commencement of the within action and now is a citizen and resident of the State of California.

"(4) The plaintiff was at the time of the commencement of the within action and had been at all times since on or about the month of June 1950 the owner and holder of 400 shares of the common stock of the defendant Corporation, being approximately 1.6% of the total issued and outstanding shares of the common stock of said Corporation.

"(5) The plaintiff brings this action as a derivative action in the right of and on behalf of the defendant Corporation, and seeks to recover a judgment in favor of said Corporation. Said Corporation is a real party in interest herein and an indispensable party.

"(6) The defendants, John P. Lordan, Maynard Brandsma, Francis E. Browne, Robert W. Langley, and Harry F. Dietrich were elected Directors of the defendant Corporation on or about February 28, 1949, and constituted its entire Board of Directors until March 25, 1953 when four of said five Directors (to wit, defendants Maynard Brandsma, Francis E. Browne, Robert W. Langley and Harry F. Dietrich) resigned and Messrs. Shirley C. Burden, Robert Denny, Homer Burnaby and Robert H. Clark were elected as Directors of said Corporation. At all times since March 25, 1953, the Board of Directors of the defendant Corporation has consisted of said Messrs. Shirley C. Burden, Robert Denny, Homer Burnaby and Robert H. Clark, and the defendant, John P. Lordan.

"(7) The defendant, Ross J. Ferrar, is now and at all times since September 15, 1950 has been employed by the defendant Corporation as General Business Manager. He has never been a Director of the Corporation. He was elected Treasurer of the Corporation on or about December 6, 1950 and has held that office at all times since and he was elected Secretary of the Corporation on or about December 8, 1952 and has held that office at all times since.

"(8) Plaintiff did not at any time prior to the commencement of the within action demand that the Board of Directors of the defendant Corporation or demand that the Corporation institute the within action in its own name or otherwise; and any such demand would have been futile. Plaintiff did on the 30th day of April, 1953, a few hours prior to the filing of the within action, deliver to the defendant, Ross J. Ferrar, a one page demand that the Corporation join plaintiff in prosecuting the within

action in this Court. Said demand was dated April 27, 1953, signed by the plaintiff, George R. Carr, and addressed to the Board of Directors of the Beverly Hills Corporation, and a true and correct copy of said demand, dated April 27, 1953, is attached to the Complaint herein, marked Exhibit G.

"(9) The amount in controversy in this action, exclusive of interest and costs, exceeds the sum of $3,000.

"(9A) The within action is not a collusive one to confer on a Court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction.

"(10) The defendant Corporation has not been under the domination of the individual defendants herein, or of any of them, or under the control of any person or persons who have been antagonistic or hostile to the financial interests of the Corporation, at any time since at least as early as March 25, 1953, and the defendant Corporation was not at the time of the commencement of the within action and is not now incapacitated from bringing or maintaining suit upon any cause or causes of action which may exist in its favor, including but not limited to the alleged causes of action set forth in plaintiff's Complaint herein, and said Corporation was not at the time of the commencement of the within action and is not now incapacitated from protecting its own financial interests.

"(11) Although formally designated as a defendant herein by the plaintiff, for the purpose of determining whether diversity of citizenship exists, the defendant Corporation must be realigned with the plaintiff as a plaintiff.

"(12) The within action is not one between citizens of different states and this Court did not have at the time of the commencement of the within action and does not

now have, jurisdiction, over the subject matter of the within action."

Upon the basis of these findings of fact, the trial court correctly realigned the parties and dismissed the cause for lack of jurisdiction.

Affirmed.

(Endorsed:) Opinion. Filed May 23, 1956.

Paul P. O'Brien, Clerk.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1956.

No. 468.

GEORGE R. CARR,

Petitioner,

vs.

BEVERLY HILLS CORPORATION, a corporation; JOHN P. LORDAN, MAYNARD BRANDSMA, FRANCIS E. BROWNE, ROBERT W. LANGLEY, HARRY F. DIETRICH, and ROSS J. FERRAR,

Respondents.

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

BRIEF OF RESPONDENT BEVERLY HILLS CORPORATION IN OPPOSITION.

Question Presented.

Whether the court below was in error in holding that the District Court lacked jurisdiction, on the ground of diversity of citizenship, to hear a derivative stockholder's suit where the corporation, the real party in interest and for whose benefit the action was brought, is a cititzen of the same state as the individual defendants, and the evidence clearly shows that the corporation has an independent board of directors, is not controlled by any of the individual defendants, and is not incapacitated from filing suit itself or from otherwise protecting its own financial interests.

Statutes Involved.

The statutes involved are Title 28, United States Code, Section 1332(a)(1) (set forth in Appendix A of the Petition), Rule 23(b), Federal Rules of Civil Procedure (also set forth in Appendix A of the Petition), and Rules 12(h) and 52(a), Federal Rules of Civil Procedure (printed in Appendix A, *infra*).

Statement of the Case.

Petitioner's statement of the case is devoted almost exclusively to a recitation of matters allegedly going to the "merits" of the action but which are clearly immaterial to a determination of the jurisdictional issue. Respondents twice tried to have the District Court determine these matters on their merits by motions but the trial court decided that it was without jurisdiction to do so. Therefore, we shall confine our brief to the facts relating to the issue of jurisdiction.

Petitioner is an Illinois citizen and the holder of 400 shares (1.6%) of stock in respondent Beverly Hills Corporation [R. 265]. Respondent Beverly Hills Corporation is organized pursuant to the laws of the State of California and all of the other respondents are citizens of and residents of the State of California [R. 265].

In the month of December, 1952, respondent corporation for the first time learned that petitioner was dissatisfied with the handling of some of the affairs of the corporation [R. 118, 122]. Immediately representatives of the corporation furnished information as requested to

petitioner, including an audit report covering all transactions between the corporation and the Beverly Hills Clinic [R. 138-140].

On March 25, 1953, four new members of the board of directors (Messrs. Denny, Clark, Burnaby, and Burden) of respondent corporation were elected and took office, replacing on said board respondents Brandsma, Browne, Langley, and Dietrich [R. 90, 94, 101, 110, 134, 135]. None of said new board members was a stockholder of said corporation or a partner of the Beverly Hills Clinic, but each was a well-known business leader in the Los Angeles area [R. 48, 51, 53, 134, 135, 182]. Petitioner's counsel was promptly notified of the names of the new members of said board of directors [R. 137], and was informed in writing on March 25, 1953, that if "there are any possible corporate claims which you think should be given attention, there is now an independent Board of Directors of the Corporation which will be available to give careful consideration to any matters when submitted by you" [R. 137]. No claims of any kind have ever been made by petitioner or his counsel to said new board of directors [R. 48, 51, 55, 182].

Only a few hours before petitioner filed the action, he delivered to respondent Ferrar a copy of the complaint herein, together with a "demand" that the corporation "join" in prosecuting the action against the individual respondents [R. 44, 45, 98, 99]. The complaint was, in fact, filed the same day and before the board of directors could even be called together to act upon said "demand"

[R. 99, 100, 140]. The complaint is purportedly filed "on behalf" of the corporation [R. 2] and seeks a money judgment in favor of the corporation [R. 25, 26].

The new board of directors of respondent corporation immediately began, through new counsel, a complete and independent investigation of the facts and the law involved in the claims set forth in the complaint herein [R. 56-57]. Said investigation continued through the course of four or five weeks [R. 58]. During said investigation, respondent corporation's counsel made a written request upon petitioner's counsel for any information petitioner had to support his charges [R. 80-82]. No such information has ever been furnished to the corporation or to any of its representatives [R. 76, 83-85, 192, 196].

The board of directors of respondent corporation met on June 24, 1953, to receive and consider its counsel's written report of its investigation of the facts and the law relating to petitioner's claims herein [R. 58]. Said board carefully analyzed each of the claims of the complaint and its counsel's findings thereon [R. 63-73]. The board of directors determined that the claims of petitioner were not meritorious; that heavy attorneys' fees, accounting charges, and other costs would be incurred by said corporation by reason of such litigation; that such litigation would probably delay the pending dissolution of the corporation; and that the expense and detriment which would be caused thereby to the corporation would far exceed any possible recovery in the suit

[R. 72, 73]. Accordingly, the independent board of directors resolved that for the best interests of said corporation and its stockholders, the corporation should not join in or prosecute the action but should "take whatever steps are necessary or possible to terminate the litigation with the least possible expense to the corporation" [R. 73].

The District Court found upon the above facts and other evidence that respondent corporation is the real party in interest herein and an indispensable party [R. 265]: that respondent corporation was not under the domination or control of any of the individual respondents or of any person who has been antagonistic or hostile to the financial interests of the corporation; and that the corporation was not and is not incapacitated from bringing or maintaining suit upon any cause of action which may exist in its favor or from protecting its own financial interests [R. 268].

The District Court under all of the circumstances determined that respondent corporation should be realigned as a plaintiff [R. 268]. Such realignment placed a California corporation among the plaintiffs and California citizens as defendants in the suit. There was, therefore, no diversity of citizenship and the District Court dismissed the action for lack of jurisdiction [R. 268, 269, 272].

The Court of Appeals for the Ninth Circuit affirmed the judgment of the District Court. (Appendix B of Petition.)

ARGUMENT.

The issue here is a narrow one and its determination below was based entirely upon the peculiar facts of the case. These facts were found by the District Court upon evidence which clearly supports the judgment. There is no real conflict between the decision below and decisions of this Court, and the Court of Appeals decision does not conflict with decisions of other Courts of Appeal. The decision below presents no issue of any substantial importance and does not warrant review by this Court on certiorari.

I.

The Decision Below Is Clearly Correct.

The decision below recognizes that the District Court was not bound, in determining jurisdiction upon the basis of diversity of citizenship, by plaintiff's arrangement of the parties but properly could look beyond the pleadings and arrange the parties according to the facts. The facts respecting jurisdiction were fully presented upon affidavits without objection, and showed clearly that when suit was filed an independent board of directors was in charge of the affairs of the Beverly Hills Corporation and was not dominated by the individual respondents or by anyone antagonistic to the interests of the corporation. The causes of action alleged in petitioner's derivative stockholder's complaint belonged to the corporation. The alleged "matter in controversy" was therefore one between the corporation, on whose behalf suit was brought, and the individual respondents. Since the corporation ("the real party in interest") and the individual respondents were all citizens of the State of California, the District Court, upon realignment of the parties, properly dismissed the action for lack of jurisdiction.

For purposes of jurisdiction, "the pleadings may be put aside, and the parties placed on different sides of the matter in dispute according to the facts". *Removal Cases, Meyer v. Delaware R. R. Construction Co.,* 100 U. S. 457, 469, 25 S. Ct. 591, 25 L. Ed. 593 (1879). It is the duty of the trial court thus to align the parties according to their real interests. *Helm v. Zarecor,* 222 U. S. 32, 32 S. Ct. 10, 56 L. Ed. 77 (1911).

In a stockholder's derivative suit such as the case at bar, the corporation is the real party in interest and is an indispensable party. *Meyer v. Fleming,* 327 U. S. 161, 167, 66 S. Ct. 382, 90 L. Ed. 595 (1946). In California, "As a general rule of law . . . where a stockholder of a corporation seeks to maintain an action for a wrong done to the corporation, such stockholder occupies no better or different position with relation thereto than would the corporation itself suing in its own behalf." *Reid v. Robinson,* 64 Cal. App. 46, 55, 220 Pac. 676, 680 (1923).

A stockholder has no absolute right to bring an action on behalf of his corporation. He may maintain such an action when the corporation is "disabled from protecting itself". *Koster v. (American) Lumbermens Mutual Co.,* 330 U. S. 518, 522-523, 67 S. Ct. 828, 91 L. Ed. 1067 (1947). Where the corporation is not under such disability, "it has a real interest in the litigation and it should be aligned as a party plaintiff, where its interest lies". *Hamer v. New York Railways Co.,* 244 U. S. 266, 37 S. Ct. 511, 514, 61 L. Ed. 1125 (1916).

The decisive factual question, therefore, in determining whether to align the corporation as a party defendant or as a plaintiff in a stockholder's derivative action is this: is the corporation in "antagonistic hands" so that

it is incapacitated to act to protect its own financial interests? Only when the corporation is so incapacitated is it proper to align it as a defendant in determining if diversity of citizenship exists. See *Doctor v. Harrington*, 196 U. S. 579, 25 S. Ct. 355, 49 L. Ed. 606 (1905); *Venner v. Great Northern Ry. Co.*, 209 U. S. 24, 28 S. Ct. 328, 52 L. Ed. 66 (1908); *Koster v. (American) Lumbermens Mutual Co., supra.*

The burden was upon petitioner to prove to the District Court that it had jurisdiction of the cause. *McNutt v. Gen. Motors etc. Corp.*, 298 U. S. 178, 189, 56 S. Ct. 780, 80 L. Ed. 1135 (1936). This he failed utterly to do. Rather, it was clearly shown that the corporation was not in antagonistic hands and was fully able to protect its own financial interests [R. 267, 268].

The fact that the independent board of directors failed to "join" in or prosecute the action would not prove that the corporation was in antagonistic hands. A disagreement between a stockholder and his corporation over the advisability of prosecuting a claimed cause of action for the benefit of the corporation does not show that the managers of the company are antagonistic to the interests of the corporation. A decision not to litigate a poor lawsuit will preserve—not defeat—the corporate interest. It is interesting to note that if the corporation had "joined" in the suit as petitioner had purportedly "demanded", the very diversity upon which petitioner relies would have been extinguished.

Petitioner's complaint does not even pass the test he apparently claims is established by such decisions as *Doctor v. Harrington, supra.* He fails to allege that the board of directors of the corporation at the time suit was filed was dominated by or under the control of any of the

individual respondents, or that said board abused its discretion in not bringing suit, or that its failure to "join" in or institute the suit was improper or wrongful. Under California authorities the complaint failed to state a claim upon which relief could be granted in the absence of such allegations. *Findley v. Garrett,* 109 Cal. App. 2d 166, 240 P. 2d 421 (1952), (hearing denied by California Supreme Court), establishes that a good faith determination by an independent board of directors not to sue certain directors of a corporation is a bar to a stockholder's derivative suit.

See also *Corbus v. Alaska Treadwell Gold Min. Co.,* 187 U. S. 455, 23 S. Ct. 157, 47 L. Ed. 426 (1903); *Ashwander v. T. V. A.,* 297 U. S. 288, 56 S. Ct. 466, 80 L. Ed. 688 (1936); *Denicke v. Anglo-Calif. Nat. Bank* (9th Cir., 1944), 141 F. 2d 285.

Petitioner does not seriously challenge the adequacy of the evidence to support the judgment below. Certainly he has not shown that the Findings of Fact of the District Court are clearly erroneous, within the meaning of Rule 52(a) of the Federal Rules of Civil Procedure.

Petitioner misconstrues the decision of the Court of Appeals when he states that the action was dismissed "apparently for non-compliance with Rule 23(b) of the Rules of Civil Procedure" (Petition, p. 12). The decision below was not based on that ground at all but on lack of diversity. It is firmly established that Rule 23(b) does not deal with the jurisdiction of the courts but only prescribes the method by which jurisdiction shall be exercised. *Venner v. Great Northern Ry. Co., supra* (discussing the purpose of old Equity Rule 94, predecessor of present Rule 23(b)).

The District Court's finding that no demand for relief was made prior to suit by petitioner upon the corporation's board of directors, and that such a demand would have been "futile" [R. 266], is not inconsistent with its other findings. The board of directors had decided after a full investigation that the interests of the corporation would not be served by filing suit [R. 63-73]. A finding that a prior demand would have been "futile" merely made it clear from the Findings of Fact as a whole that the District Court dismissed the action because of the absence of diversity, not because of failure to comply with Rule 23(b).

The action of the board of directors in declining to join in or to prosecute the suit was made in good faith and upon sound grounds: the possibility of failure of the suit, the heavy legal and other expenses which the corporation would incur through litigation, possible delays in completing the pending dissolution of the corporation if the suit was maintained, and other cogent reasons [R. 72-73]. Further, the corporation would have been required to indemnify any and all of the individual respondents for their reasonable expenses and attorneys' fees if any of them was "successful in whole or in part" in defending the suit, whether the action was brought by the plaintiff or the corporation. California Corporations Code, Section 830.

Under these circumstances, and based upon advice of counsel who studied the matter carefully, the corporation's decision not to sue was not hostile to the corporation but, in fact, was an attempt to preserve the financial interests of the company. The corporation's motion to dismiss the action at an early stage was an eminently practical meas-

ure to avoid further legal expense to the corporation, expense which would surely have resulted from plaintiff's attempt to launch the company into prolonged and fruitless litigation.

II.

There Is No Conflict of Decisions.

The decision below does not conflict with decisions of this Court or with decisions of other Courts of Appeal. Where the courts have refused in derivative stockholders' actions to align the corporation as a party plaintiff, such refusal has been based upon facts, disclosed by the pleadings or evidence, showing that the corporation was controlled by the alleged wrongdoers or was otherwise disabled from protecting itself.

So in *Doctor v. Harrington, supra,* the court took as true the allegation that the "board of directors . . . is under the absolute control and domination of . . . John T. Harrington [who] by reason of having possession of a majority of the capital stock . . . likewise controls the action of the stockholders" 196 U. S. Ct., page 352.

In *Venner v. Great Northern Ry. Co., supra,* the jurisdictional facts were taken from plaintiff's bill, where it was alleged that "defendant James T. Hill . . . was the president of the other defendant, the Great Northern Railroad . . . and that railroad and its board of directors were under his absolute control." 209 U. S. at page 29.

The court found in *Cutting v. Woodward* (9th Cir., 1918), 255 Fed. 633, that the individual defendant and the corporation had engaged in *actual fraud* during the period when the individual defendant had virtual control of the

majority of the board of directors, and "they were ever ready to do his bidding".

Delaware & Hudson Co. v. Albany & Susquehanna, 213 U. S. 435, 29 S. Ct. 540, 53 L. Ed. 862 (1909), is a case where "the antagonism between the director and the corporate interest [is] unmistakable".

Koster v. (American) Lumbermens Mutual Casualty Co., supra, is a *forum non conveniens* case in which the court discussed the matter herein involved in dictum, and commented that "jurisdiction is saved in this class of cases by a special dispensation because the corporation is in antagonistic hands". 330 U. S. at page 523.

Groel v. United Electric Co. (C. C. N. J., 1904), 132 Fed. 252, was a suit by a stockholder against another corporation in which the court took as true the allegations of the bill which showed that "the New Jersey corporation is in the control of officers who are carrying out the purposes of the Pennsylvania company and its confederates". *East Tennessee V. & G. R. Co. v. Grayson,* 119 U. S. 240, 7 S. Ct. 190 (1886), is not a derivative suit but involved a complaint against illegal acts of the corporation itself.

The remaining cases cited by petitioner in his brief do not deal at all with the question of whether diversity exists after a proper alignment of parties in stockholders' derivative suits.

The decision of the court below is consistent with *Hamer v. New York Railways Co., supra,* where this Court affirmed dismissal of a stockholder's derivative suit after realignment of the corporation as a party plaintiff, "where its interest lies". 37 S. Ct. 514. The decision is also in harmony with *Dannmeyer v. Coleman*

(C. C., D. Calif., 1882), 11 Fed. 97, 103, where an alternative ground for dismissal of a stockholder's derivative suit against California citizens was the lack of jurisdiction which resulted from realigning the California corporation as a party plaintiff.

III.

No Important Question Is Presented.

There is no important legal or social question presented by the petition. The opinion of the Circuit Court is based entirely upon the Findings of Fact of the District Court. The opinion is succinct and expresses no generalizations which might control some different factual situation. The decision, therefore, can truly be said to turn upon its own facts.

The independence of the board of directors of the Beverly Hills Corporation and its good faith in determining not to bring suit were overwhelmingly supported by the evidence. This is a case totally unlike that presented by the ordinary type of stockholder's derivative suit, where at the time of suit the defendant officers or directors control the corporation. Accordingly, the decision below will not affect the course of the typical stockholder's derivative suit.

The result reached by the court below was fair and correct. A stockholder in California is not entitled to maintain a derivative action where the corporation is a free agent and for good cause refuses to be launched into expensive litigation. He should not be allowed to try to circumvent this wise policy by resorting to the already overcrowded federal courts for settlement of controversies which properly have no place there.

We understand that this Court has very recently granted petitions for a writ of certiorari in *Smith v. Sperling* (D. C. Cal., 1953), 117 Fed. Supp. 781 (9th Cir., 1956, No. 14,334, not yet reported), and *Swanson v. Traer* (7th Cir., 1956), 230 F. 2d 228. That fact, in our opinion, should not necessarily cause the Court to grant the within petition. First, the cases should, of course, be considered upon their own individual merits and, whatever the jurisdictional facts may show in the cited cases, we are confident that here the evidence supporting the Findings of Fact cannot be seriously challenged. Secondly, the complaint in the case at bar, apparently unlike those filed in said cited cases, fails even to allege that the board of directors was controlled or dominated by the alleged wrongdoers when suit was filed. These considerations justify, we believe, this Court's different treatment of the instant petition.

Conclusion.

For the foregoing reasons, we respectfully submit that the petition for a writ of certiorari should be denied.

Respectfully submitted,

PAUL R. WATKINS,

Counsel for Respondent Beverly Hills Corporation.

IRA M. PRICE II,

CHARLES E. HORNING, JR.,

LATHAM & WATKINS,

Of Counsel.

Dated: October 24, 1956.

APPENDIX A.

Rule 12(h), Federal Rules of Civil Procedure.

". . . A party waives all defenses and objections which he does not present either by motion as hereinbefore provided or, if he has made no motion, in his answer or reply, except . . . (2) that, whenever it appears by suggestion of the parties or otherwise that the court lacks jurisdiction of the subject matter, the court shall dismiss the action. The objection or defense, if made at the trial, shall be disposed of as provided in Rule 15(b) in the light of any evidence that may have been received."

Rule 52(a), Federal Rules of Civil Procedure.

". . . In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. . . ."

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III.

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IV.

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IN THE

Supreme Court of the United States

October Term, 1956.
No. 468

GEORGE R. CARR,

Petitioner,

vs.

BEVERLY HILLS CORPORATION, a corporation; JOHN P. LORDAN, MAYNARD BRANDSMA, FRANCIS E. BROWNE, ROBERT W. LANGLEY, HARRY F. DIETRICH, and ROSS J. FERRAR,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Brief of Respondents John P. Lordan, Maynard Brandsma, Francis E. Browne, Robert W. Langley, Harry F. Dietrich and Ross J. Ferrar in Opposition to Petition for Writ of Certiorari.

Petitioner's statement of Questions Presented: (1) begs the question by assuming that jurisdiction of the District Court was "properly invoked" in the first instance and was "destroyed" by that Court in realigning the Corporation as a plaintiff, (2) incorrectly states that the Corporation "unites" with the other defendants in resisting plaintiff, and (3) incorrectly suggests that "a demand had been made to bring suit." (Pet. p. 2.) Hence, the individual respondents herewith set forth their own statement of the Questions Presented as is permitted by Rule 40(3) of this Court.

Questions Presented.

(1) Whether the Court below was in error in affirming the judgment of the District Court that it lacked diversity jurisdiction to hear a stockholder's derivative suit, where (a) the Corporation is admittedly the real party in interest and the party for whose benefit the action was brought, (b) the Corporation is a citizen of the same State as all individual defendants, and (c) the District Court found that at the time of and for at least five weeks prior to the commencement of the action, the Corporation had an independent Board of Directors, was not controlled by all or any of the individual defendants, and was not incapacitated in any way from filing the suit itself or from otherwise protecting its own financial interest; and

(2) Whether, in any event, this Court should afford its facilities to petitioner when it appears that the action is sham, frivolous and vexatious.

Statutes Involved.

In addition to the statutes and rules referred to by petitioner, we also consider that Rule 12(h) and Rule 52(a) of the Federal Rules of Civil Procedure (Appendix A hereto) are pertinent.

Statement of the Case.

Petitioner's statement of the case is devoted almost entirely to what he deems to be the merits of his charges (on behalf of the respondent Corporation) against the individual respondents and he thus fails to set forth most of the facts which are really determinative of the jurisdictional issue involved. This deficiency in petitioner's statement is due to his failure to differentiate between (1) facts material to the question of the merits of the alleged claims

of the respondent Corporation against the individual respondents, a question not passed upon below [R. 272], and (2) facts material to the question of whether petitioner had a right to bring a derivative action in the first instance and thus to designate the respondent Corporation as a true defendant and create diversity where none would exist if the Corporation had brought the action on its own behalf.

All of petitioner's charges against the individual respondents were specifically denied in the Court below [R. 90-97, 101-120, 223-241], but the details of such denials and attendant explanations need not be here set forth because, as noted, they were not passed upon below and are not relevant to the question of jurisdiction. For the same reason, we will not go into the details of the partnership known as the Beverly Hills Clinic (hereinafter referred to as the "Clinic") or its relations with the respondent Corporation (hereinafter referred to as the "Corporation") because they likewise are wholly irrelevant to the jurisdictional issue.

In June 1950 the petitioner purchased 400 shares of common stock of the Corporation [R. 265], and he was such a stockholder at the commencement of the action. His holding represents 1.6% of the total outstanding shares and cost him $400 [R. 234, 265]. At all of the times mentioned in the Complaint, petitioner's son-in-law, one Dr. Omar Fareed, was also a small stockholder as well as a partner in the Clinic [R. 116-117]. Donald A. Fareed, a brother of Dr. Fareed, was likewise a small stockholder [R. 226], and acted as attorney for and secretary of the Corporation from December 6, 1950 to December 4, 1952 [R. 116, 225] during which time he advised the Corporation concerning all of the alleged transactions now complained

of, with the single exception of the matter alleged in the third cause of action of the Complaint [R. 117].

The two Fareed brothers were fully informed of all matters relating to the Corporation and communicated at length with petitioner concerning those matters throughout the periods described in the Complaint [R. 221, 234, 235]. The true facts concerning the transactions now complained of were never concealed and such of the transactions as actually occurred took place with the full knowledge or means of knowledge, and acquiescence of all stockholders [R. 118].

No objection to any of the corporate transactions was made by any stockholder until December of 1952, when one of petitioner's counsel made certain objections and requested certain information from the officers of the Corporation [R. 118, 122]. In response to this request, all of the Corporation's books and records were promptly (on December 3, 1952) made available to petitioner's counsel, but he refused to examine or inspect said books and records [R. 122]. The following day (December 4, 1952) Donald A. Fareed resigned as counsel and the law firm of Gibson, Dunn & Crutcher was retained by the Corporation [R. 116, 142].

Between early December 1952 and the latter part of April 1953 the new counsel for the Corporation made available to petitioner's counsel for examination and copying numerous documents and papers of the Corporation [R. 126-129, 132-134] and arranged to have the firm of Haskins & Sells, certified public accountants, make a complete audit of all transactions between the Corporation and the Clinic [R. 129-131]. This was promptly done, and a copy of the audit report was furnished to petitioner's counsel on April 18, 1953 [R. 137-138].

In the meantime, on March 25, 1953, four new members of the five-man Board of Directors of the Corporation were elected, replacing on that Board the individual respondents Brandsma, Browne, Langley, and Dietrich [R. 90, 94, 101, 110, 134, 135]. None of the new Board members was a stockholder of the Corporation or a partner in the Clinic, and each was a well-known businessman and civic leader [R. 48, 51, 53, 134, 135, 182]. Petitioner's counsel was immediately notified of the names of the new Board members and was informed, in writing, on March 25, 1953 that "If after your study of the whole matter, there are any possible corporate claims which you think should be given attention, there is now an independent Board of Directors of the Corporation which will be available to give careful consideration to any matters when submitted by you" [R. 136-137]. No claims of any kind were ever made or submitted by petitioner or his counsel to the new Board of Directors [R. 48, 51, 55, 182].

On April 30, 1953 (some 36 days after being notified of the election of the new Board of Directors and 12 days after being furnished the special Haskins and Sells' audit), petitioner delivered to respondent Ferrar a copy of the Complaint herein, to which was attached a letter addressed to the Board of Directors stating that "George R. Carr [the petitioner] is filing the attached complaint with the United States District Court for the Southern District of California" and demanding that the Corporation "join him in prosecuting the civil action he is bringing against" the individual respondents [R. 44, 45, 98, 99].

The Corporation's counsel advised petitioner's counsel that he would call a meeting of the Board of Directors as soon as possible that afternoon to consider the claims of petitioner, but petitioner's counsel replied that the com-

plaint would be filed that day regardless of action by the Board of Directors [R. 99, 100] and the action was in fact filed that same afternoon.

On May 4, 1953, the complaint and claims of petitioner were brought to the attention of the new Board of Directors of the Corporation and upon the suggestion of Gibson, Dunn, and Crutcher that the Corporation might desire to secure new legal counsel, the new Board selected and retained the law firm of Latham and Watkins to represent the Corporation [R. 56, 142], and said last-mentioned law firm has represented the Corporation at all times since.

The new Board of Directors of the Corporation immediately began, through its new counsel, a complete and independent investigation of the facts and law involved in the claims set forth in petitioner's complaint, which investigation covered a period of four or five weeks [R. 56-58]. During the investigation, counsel for the Corporation repeatedly asked petitioner's counsel for any information which he had to support his charges, but none was furnished [R. 82, 83-85, 86-87].

A conference was finally held between counsel for petitioner and the Corporation on July 10, 1953 [R. 76], at which time, the Corporation's counsel reported results of his investigation and his tentative conclusions and again requested petitioner for information or proof to support his claims [R. 76, 192, 193]. Except for matters of minor importance, petitioner's counsel did not then furnish any of the requested information and never has furnished the same [R. 76, 197].

Meanwhile, on June 24, 1953, the new Board of Directors of the Corporation had a special meeting to receive and consider its counsel's report of its investigation of petitioner's claims [R. 58]. After thorough analysis

and discussion of each of the claims, the Board of Directors (except respondent Lordan who did not participate in the discussion and did not vote) adopted a resolution to the general effect that since the claims of petitioner were not supported by the facts and the prosecution of petitioner's claims would not be in the best interests of the Corporation, the Corporation should not join in or prosecute the action instituted by the petitioner, but should take whatever steps were necessary and possible to terminate the litigation with the least possible expense to the Corporation [R. 63-73].

The four new members of the Board of Directors (*i.e.* Messrs. Burnaby, Denny, Clark and Burden) are not charged with having anything to do with the alleged transactions complained of by the petitioner; and there has been no attempt by any individual respondent or anyone else to influence the new Board of Directors in the exercise of that Board's judgment and discretion [R. 49, 52, 57, 58, 183].

The Corporation is in the process of a voluntary wind-up and dissolution upon the written consent of over 90% of its stockholders [R. 128]. The assets of the Corporation have been sold at a profit [R. 127, 128, 141]. From the proceeds of such sale, all stockholders (including the petitioner) have been repaid the full amount of their loans, plus interest, and it is anticipated that at the completion of the dissolution, the Corporation will return to its stockholders the full purchase price paid for its stock plus a profit of about 75% of the purchase price, unless the cash remaining for distribution is dissipated in the costs and expense of this litigation [R. 141].

The Complaint herein is filed "on behalf" of the Corporation [R. 2] and prays for a money judgment in favor

of the Corporation [R. 25, 26]. Hence it is clear that the action is a derivative action and that the Corporation is the real party in interest and an indispensable party [R. 265]. Although petitioner affirmatively pleaded the fact that four of the five members of the Board of Directors were replaced by new personnel on March 25, 1953 [R. 11], which was more than five weeks prior to the commencement of the action, the Complaint also admits that no demand was made that the Corporation take action and the Complaint does not allege that the new Board of Directors has acted improperly in any way, or that it refused to bring the action, or that it abused its discretion in not bringing or maintaining the action.

None of the majority of the present Board of Directors of the Corporation is or has been under the domination or control of any of the individual respondents or of anyone who has been antagonistic or hostile to the financial interests of the Corporation [R. 49, 51, 52, 57, 92, 96, 103, 108, 112, 119, 183, 267, 268] and the Corporation was not, at the time of the commencement of the action, incapacitated from bringing or maintaining suit upon any cause of action which might exist in its favor or from protecting its own financial interests [R. 268].

Under all of the circumstances, the District Court ruled that although designated as a defendant by the petitioner, the Corporation must be aligned as a plaintiff for the purpose of determining whether the necessary diversity existed [R. 268]. The result of such realignment was that the requisite diversity of citizenship did not exist and, accordingly, the Court dismissed the action for lack of jurisdiction [R. 269, 272].

The United States Court of Appeals for the Ninth Circuit affirmed the judgment of the District Court.

ARGUMENT.

Petitioner inaccurately and unfairly criticizes the trial court when he refers to the "subterfuge of 'trial by affidavit'" [Pet. p. 13]. The fact is that at the hearing of this matter, the trial court advised counsel "that the court would also receive additional affidavits *and oral evidence*" if counsel desired to offer it [R. 264, 271], but petitioner offered none.

Petitioner is also inconsistent in his criticism of the Court below. For example, on page 12, petitioner states that the dismissal was "apparently for non-compliance with Rule 23(b)," while on the following page 13 he asserts "the rulings below were in no way based upon an alleged failure of petitioner to comply with the requirements of Rule 23(b)." Nevertheless, we believe it is his position that because he *alleged* diversity, the Court below was powerless to do anything about it.

In other words, it seems to be petitioner's position that his suit was "in classical compliance with Rule 23(b)" [Pet. p. 12] and that "Absent collusion, the instant *complaint* was one which clearly conferred jurisdiction in the District Court" [Pet. p. 13] and hence, that the trial Court could not look behind the complaint to get at the actual facts.

In making such argument, petitioner is wholly mistaken, as will appear from our brief analysis of the cases cited by petitioner [Pet. pp. 10-11] as well as certain authorities which actually control this situation.

I.

The Decision Herein Is Completely in Accord With Prior Decisions of This Court Announcing the Rule That in Determining the Question of Diversity Jurisdiction, the Mere Form of the Pleading May Be Disregarded and the Parties Aligned in Their True Position According to the Facts.

Plaintiff first argues that in realigning the parties "where proper *diversity* had been *alleged,*" the courts below "departed from established legal precedent" [Pet. p. 10]. Petitioner could hardly be more incorrect in this assertion, in view of the prior decisions of this Court announcing the rule that in determining jurisdiction, the courts are *not* bound by the pleadings. See for example the following four decisions wherein the Court looked beyond the pleadings, realigned the parties according to their real interests and dismissed for lack of diversity jurisdiction:

Hamer v. New York Railways Co. (1917), 244 U. S. 266, 61 L. Ed. 1125;

Niles-Bement-Pond Co. v. Iron Moulders Union (1920), 254 U. S. 77, 81-82, 65 L. Ed. 145, 148;

Lee v. Lehigh Valley Coal Co. (1925), 276 U. S. 542, 543, 69 L. Ed. 782, 783;

City of Indianapolis v. Chase National Bank (1941), 314 U. S. 63, 86 L. Ed. 47.

The foregoing rule in diversity cases is paralleled by other decisions of this Court holding that the mere allegation that the proper jurisdictional amount is involved is not controlling and approving a dismissal of the action

where facts dehors the complaint show that the jurisdictional amount is not in fact involved.

Paul V. McNutt v. Gen. Motors Acceptance Corp. (1935), 298 U. S. 178, 80 L. Ed. 1135;

KVOS v. Associated Press (1936), 299 U. S. 269, 81 L. Ed. 183.

The same rule is applied in testing jurisdiction where removal is sought, that is, the Courts are not bound by the pleadings.

Removal Cases (1879), 100 U. S. 457, 469, 25 L. Ed. 593, 598.

II.

The Decision Herein Is Not in Conflict With Any of the Decisions Cited by Petitioner.

None of this Court's decisions to which petitioner refers [Pet. pp. 10-11] are in conflict with the decision in the case at bar, as will appear from the following brief analysis.

The cases of *Central R.R. Co. of New Jersey v. Mills* (1884), 113 U. S. 249, 28 L. Ed. 949 and *Railroad v. Grayson* (1886), 119 U. S. 240, 30 L. Ed. 382, were not derivative suits, but involved private actions against allegedly illegal acts of the corporations themselves. Moreover, in each instance no attempt was made to go behind the pleadings.

In *Doctor v. Harrington* (1904), 196 U. S. 579, 49 L. Ed. 606 and *Venner v. Great Northern* (1907), 209 U. S. 24, 52 L. Ed. 666, the corporation involved was alleged to be under the domination or control of the officers or board of directors whose fraudulent or illegal actions the suit sought to redress, and each case was decided on the face of the pleadings. No attempt was made to show the actual facts.

The case of *City of Indianapolis v. Chase National Bank* (1941), *supra*, 314 U. S. 63, 69, 86 L. Ed. 47, 50, is one which we consider favorable to our position, and the same is true of *Koster v. Lumbermen's Mutual Gas* (1946), 330 U. S. 518, 91 L. Ed. 1067. In the former case the rule of alignment was clearly enunciated, while in the latter this Court dismissed a derivative action under the doctrine of *forum non conveniens*, but commented by way of dictum that jurisdiction in derivative stockholders' actions was saved "because the corporation is in antagonistic hands," (330 U. S. at p. 523, 91 L. Ed. at p. 1073). *A fortiori* the jurisdiction in derivative cases is *not* saved where, as here, the corporation is *not* in antagonistic hands.

The case of *Meyer v. Fleming* (1945), 327 U. S. 161, 90 L. Ed. 595, involved the disallowance of a claim in a railroad reorganization proceeding in bankruptcy. The question of diversity of citizenship or realignment was not discussed except by way of *dicta*, which is favorable to our position, this Court saying that in a derivative action the corporation "is only nominally a defendant, since any judgment obtained against the real defendant runs in its favor" (327 U. S. at p. 167, 90 L. Ed. at p. 600).

Petitioner also contends that the decision in the within case is in conflict with decisions of other Courts of Appeals, citing four cases [Pet. pp. 10-11]. Again, a brief study of these cases will show that they are not in conflict with the within decision.

Thus, in *Groel v. United Electric Co.* (C. C. N. J., 1904), 132 Fed. 252, 265, the Court in remanding the case to the State Court after it had been removed, *accepted as true* the allegations of the complaint "that the New

Jersey company is in the control of officers who are carrying out the purposes of the Pennsylvania company and its confederates, and that their position in the controversy is one of hostility to the position assumed by the complainant."

Again, in *Lavin v. Lavin* (2d Cir., 1950), 182 F. 2d 870, the Court merely affirmed a lower Court's dismissal for lack of jurisdiction on the ground that the defendant corporation should be left as a defendant, apparently on the authority of *Doctor v. Harrington, supra.* The question of hostility or antagonism or control was not mentioned.

In the case of *Schmidt v. Esquire* (7th Cir., 1954), 210 F. 2d 908, 912, the statements on the point were *dictum,* the opinion stating that it need not consider further the plaintiff's theory of alignment since the District Court had correctly ruled that, under the circumstances of the case, the citizenship of the corporation was immaterial for the purpose of testing diversity.

Lastly, in *Cutting v. Woodward* (9th Cir., 1918), 255 Fed. 633, 635, the trial court *found* that the individual defendant and the corporation had engaged in *actual fraud* while the individual defendant had virtual control of the Board of Directors and "they were ever ready to do his bidding." Further, that the defrauding individual defendant *continued* in control and hence the all-important element of an independent Board and new counsel *intervening* between the period when the wrongful acts were alleged to have occurred and the commencement of the derivative action, was there lacking.

III.

The Decision Below Was Entirely Correct on Its Facts and Is of No Particular Social or Legal Significance.

Petitioner asserts that the within decision and the decision in the case of *Smith v. Sperling* (S. D. Cal., 1953), 117 F. Supp. 781 (affirmed by the United States Court of Appeals for the Ninth Circuit, but not yet reported)* "will effectively close the doors of the federal courts to shareholders who are compelled to bring secondary or derivative actions in order to protect themselves from their own corporations, and who seek federal jurisdiction based upon diversity of citizenship" [Pet. p. 11]. This conclusion is entirely incorrect.

All the within actions does, and that quite properly, is to prevent the federal courts from being cluttered with stockholders' derivative actions which could not have been maintained in the state court in the first instance. It also prevents a claim of "diversity" where none in fact exists. However, the decision leaves open, in either the state or federal courts, a proper derivative or secondary action where the corporation is, in fact, unable to protect itself

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*We note that this Court recently granted certiorari in this case (*i.e., Smith v. Sperling*) and in the case of *Swanson v. Traer* (7th Cir., 1956), 230 F. 2d 228, each of which was a derivative action wherein a realignment of parties was made. If these petitions were granted for the purpose of re-examining the realignment rule itself, then it is probable that the Court will desire to grant certiorari in the within action, except for the sham and vexatious character of petitioner's action. If, on the other hand, certiorari was granted in the two cases just mentioned for the purpose of examining into the particular application of the realignment rule, then we submit that certiorari should not be granted in the within case since on its facts, there is no question but what realignment properly took place.

because it is under the dominance and control of the alleged wrongdoers (a situation which did not exist in the within action) and, of course, it leaves open all situations where genuine diversity exists.

IV.

The Record in the Within Case Shows That Petitioner's Action Below Was Brought in Bad Faith, Is Sham and Vexatious, and Is the Result of Petitioner's Desire to Harass the Individual Respondents Rather Than to Correct Any Alleged Wrongs to the Corporation. Hence the Facilities of This Court Should Be Denied Him.

We have already pointed out in our Statement of the Case (a) that petitioner's stock represents only 1.6% of the outstanding stock of the Corporation, (b) was purchased by him at a cost of $400.00, (c) that the Corporation is in the process of dissolution, (d) that petitioner, as well as all other stockholders, will probably receive a profit of about 75% on their shares of stock unless the Corporation's funds are dissipated in this litigation, and (e) that since the Corporation is in the process of dissolution, any recovery in this or any other litigation would be immediately distributed *pro rata* to its stockholders.

Recognizing the above situation, the individual respondents, without in any way acknowledging any liability whatsoever, but solely in an endeavor to wind up the litigation promptly and thereby save expense to the Corporation, offered to pay petitioner his pro rata share of the full amount claimed by him for the Corporation. In other words, petitioner was promptly offered the *full* amount which *he* could possibly hope to recover by this

litigation and, as previously noted, *none* of the other stockholders was interested in *any* recovery. This sensible program for disposing of litigation which is not wanted by anyone except the petitioner was rejected by petitioner's counsel as being "unrealistic" [R. 143-144]. It is patently clear, therefore, that petitioner is not interested in a recovery but solely in litigation and harassment.

Moreover, the record show that the Corporation was being governed by a new and independent Board of Directors for at least five weeks prior to the commencement of the within action. They have determined that petitioner's action was not for the best interests of the Corporation, and no claim is made that the new Board has acted in bad faith or has abused its business discretion in determining that the action should not be brought. Hence, under well settled California law, petitioner could not have even stated a cause of action in the state court. (See: *Findley v. Garrett* (1952), 109 Cal. App. 2d 166, 240 P. 2d 421.) Since diversity jurisdiction would not change such substantive rule of law, petitioner must have known that he could not state a claim in the federal courts, even if diversity were present. Again we say, petitioner is interested in litigious harassment, not justice.

Lastly, the sham and bad faith character of the "demand" which petitioner caused to be served on the respondent Ferrar on April 30, 1953, is demonstrated (1) by the fact that it was delivered only a few hours before the action was filed, and (2) by the fact that the petitioner in that demand stated that *he was filing* the Complaint in the United States District Court and he asked the corporation *to join with him* in its prosecution [R. 44-45], yet it is manifest that *such joinder would have imme-*

diately destroyed the very diversity which petitioner now purports to crave.

We submit that this Court should not, under such circumstances, place the petitioner in a position where he can further prolong his own vexatious litigation by granting his petition for certiorari in this case.

Conclusion.

The decision in the within case is not in conflict with any of the prior decisions of this Court. It follows and correctly applies the rule that Federal Courts are not bound by the pleadings in determining their jurisdiction. The trial court expressly found, after a full hearing, that the Corporation was a completely free agent prior to and at the time of the commencement of the action and, hence, that petitioner could not create diversity by the device of designating it as a defendant. Those findings were fully supported by the evidence and were properly approved by the Court of Appeals. In addition, the action was at the moment of its inception and has been at all times since, sham and vexatious.

For all of which reasons we submit that the petition for a writ of certiorari should be denied.

Respectfully submitted,

FREDERIC H. STURDY,
Attorney for Respondents John P. Lordan, Maynard Brandsma, Francis E. Browne, Robert W. Langley, Harry F. Dietrich and Ross J. Ferrar.

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APPENDIX A.

Rule 12(h), Federal Rules of Civil Procedure.

"(h) **Waiver of Defenses.** A party waives all defenses and objections which he does not present either by motion as hereinbefore provided or, if he has made no motion, in his answer or reply, except (1) that the defense of failure to state a claim upon which relief can be granted, the defense of failure to join an indispensable party, and the objection of failure to state a legal defense to a claim may also be made by a later pleading, if one is permitted, or by motion for judgment on the pleadings or at the trial on the merits, and except (2) that, whenever it appears by suggestion of the parties or otherwise that the court lacks jurisdiction of the subject matter, the court shall dismiss the action. The objection or defense, if made at the trial, shall be disposed of as provided in Rule 15(b) in the light of any evidence that may have been received."

Rule 52(a), Federal Rules of Civil Procedure.

"(a) **Effect.** In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the op-

portunity of the trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court. If an opinion or memorandum of decision is filed, it will be sufficient if the findings of fact and conclusions of law appear therein. Findings of fact and conclusions of law are unnecessary on decisions of motions under Rules 12 or 56 or any other motion except as provided in Rule 41(b)."

No. 468. CARR *v.* BEVERLY HILLS CORP. ET AL. On petition for writ of certiorari to the United States Court of Appeals for the Ninth Circuit. *Per Curiam:* The petition for writ of certiorari is granted, the judgment of the Court of Appeals is reversed on the authority of *Smith* v. *Sperling, ante,* p. 91, decided June 10, 1957, and *Swanson* v. *Traer, ante,* p. 114, decided June 10, 1957, and the cause is remanded to the District Court for proceedings in conformity with this opinion. MR. JUSTICE FRANKFURTER, MR. JUSTICE BURTON, MR. JUSTICE HARLAN, and MR. JUSTICE WHITTAKER dissent for the reasons stated in their dissent in *Smith* v. *Sperling, ante,* p. 98. *Thomas Dodd Healy* and *George E. Danielson* for petitioner. *Paul R. Watkins* for the Beverly Hills Corporation, and *Frederic H. Sturdy* for Lordan et al., respondents. Reported below: 237 F. 2d 323.